

(2) The trust complies for such taxable year with the provisions of § 1.857-8 (relating to records required to be maintained by a real estate investment trust).

See section 858 and § 1.858-1, relating to dividends paid after the close of the taxable year.

(b) *Failure to qualify.* If a real estate investment trust does not meet the requirements of section 857(a) and paragraph (a) of this section for the taxable year, it will, even though it may otherwise be classified as a real estate investment trust, be taxed in such year as an ordinary corporation and not as a real estate investment trust. In such case, none of the provisions of part II of subchapter M (other than sections 856(g) and 857(d)) will be applicable to it. For the rules relating to the applicability of sections 856(g) and 857(d), see § 1.857-7.

(Sec. 856(d)(4) (90 Stat. 1750; 26 U.S.C. 856(d)(4)); sec. 856(e)(5) (88 Stat. 2113; 26 U.S.C. 856(e)(5)); sec. 856(f)(2) (90 Stat. 1751; 26 U.S.C. 856(f)(2)); sec. 856(g)(2) (90 Stat. 1753; 26 U.S.C. 856(g)(2)); sec. 858(a) (74 Stat. 1008; 26 U.S.C. 858(a)); sec. 859(c) (90 Stat. 1743; 26 U.S.C. 859(c)); sec. 859(e) (90 Stat. 1744; 26 U.S.C. 859(e)); sec. 6001 (68A Stat. 731; 26 U.S.C. 6001); sec. 6011 (68A Stat. 732; 26 U.S.C. 6011); sec. 6071 (68A Stat. 749; 26 U.S.C. 6071); sec. 6091 (68A Stat. 752; 26 U.S.C. 6091); sec. 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954))

[T.D. 6598, 27 FR 4087, Apr. 28, 1962, as amended by T.D. 7767, 46 FR 11277, Feb. 6, 1981]

**§ 1.857-2 Real estate investment trust taxable income and net capital gain.**

(a) *Real estate investment trust taxable income.* Section 857(b)(1) imposes a nominal tax and surtax, computed at the rates and in the manner prescribed in section 11, on the “real estate investment trust taxable income”, as defined in section 857(b)(2). Section 857(b)(2) requires certain adjustments to be made to convert taxable income of the real estate investment trust to “real estate investment trust taxable income”. The adjustments are as follows:

(1) *Net capital gain.* In the case of taxable years ending before October 5, 1976, the net capital gain, if any, is excluded.

(2) *Special deductions disallowed.* The special deductions provided in part VIII, subchapter B, chapter 1 of the Code (except the deduction under section 248) are not allowed.

(3) *Deduction for dividends paid—(i) General rule.* The deduction for dividends paid (as defined in section 561) is allowed. In the case of taxable years ending before October 5, 1976, the deduction for dividends paid is computed without regard to capital gains dividends.

(ii) *Deduction for dividends paid if there is net income from foreclosure property.* If for any taxable year the trust has net income from foreclosure property (as defined in section 857(b)(4)(B) and § 1.857-3), the deduction for dividends paid is an amount equal to the amount which bears the same proportion to the total dividends paid or considered as paid during the taxable year that otherwise meet the requirements for the deduction for dividends paid (as defined in section 561) as the real estate investment trust taxable income (determined without regard to the deduction for dividends paid) bears to the sum of—

(A) The real estate investment trust taxable income (determined without regard to the deduction for dividends paid), and

(B) The amount by which the net income from foreclosure property exceeds the tax imposed on such income by section 857(b)(4)(A).

For purposes of the preceding sentence, the term “total dividends paid or considered as paid during the taxable year” includes deficiency dividends paid with respect to the taxable year that are not otherwise excluded under this subdivision or section 857(b)(3)(A). The term, however, does not include either deficiency dividends paid during the taxable year with respect to a preceding taxable year ending before October 5, 1976, capital gains dividends.

(iii) *Deduction for dividends paid for purposes of the alternative tax.* The rules in section 857(b)(3)(A) apply in determining the amount of the deduction for dividends paid that is taken into account in computing the alternative tax. Thus, for example, if a real estate investment trust has net income from foreclosure property for a taxable year

ending after October 4, 1976, then for purposes of determining the partial tax described in section 857(b)(3)(A)(i), the amount of the deduction for dividends paid is computed pursuant to paragraph (a)(3)(ii) of this section, except that capital gains dividends are excluded from the dividends paid or considered as paid during the taxable year, and the net capital gain is excluded in computing real estate investment trust taxable income.

(4) *Section 443(b) disregarded.* The taxable income is computed without regard to section 443(b). Thus, the taxable income for a period of less than 12 months is not placed on an annual basis even though the short taxable year results from a change of accounting period.

(5) *Net operating loss deduction.* In the case of a taxable year ending before October 5, 1976, the net operating loss deduction provided in section 172 is not allowed.

(6) *Net income from foreclosure property.* An amount equal to the net income from foreclosure property (as defined in section 857(b)(4)(B) and paragraph (a) of § 1.857-3), if any, is excluded.

(7) *Tax imposed by section 857(b)(5).* An amount equal to the tax (if any) imposed on the trust by section 857(b)(5) for the taxable year is excluded.

(8) *Net income or loss from prohibited transactions.* An amount equal to the amount of any net income derived from prohibited transactions (as defined in section 857(b)(6)(B)(i)) is excluded. On the other hand, an amount equal to amount of any net loss derived from prohibited transactions (as defined in section 857(b)(6)(B)(ii)) is included. Because the amount of the net loss derived from prohibited transactions is taken into account in computing taxable income before the adjustments required by section 857(b)(2) and this section are made, the effect of including an amount equal to the amount of the loss is to disallow a deduction for the loss.

(b) *Net capital gain in taxable years ending October 5, 1976.* The rules relating to the taxation of capital gains in 26 CFR 1.857-2(b) (revised as of April 1,

1977) apply to taxable years ending before October 5, 1976.

(Sec. 856(d)(4) (90 Stat. 1750; 26 U.S.C. 856(d)(4)); sec. 856(e)(5) (88 Stat. 2113; 26 U.S.C. 856(e)(5)); sec. 856(f)(2) (90 Stat. 1751; 26 U.S.C. (856(f)(2)); sec. 856(g)(2) (90 Stat. 1753; 26 U.S.C. 856(g)(2)); sec. 858(a) (74 Stat. 1008; 26 U.S.C. 858(a)); sec. 859(c) (90 Stat. 1743; 26 U.S.C. 859(c)); sec. 859(e) (90 Stat. 1744; 26 U.S.C. 859(e)); sec. 6001 (68A Stat. 731; 26 U.S.C. 6001); sec. 6011 (68A Stat. 732; 26 U.S.C. 6011); sec. 6071 (68A Stat. 749; 26 U.S.C. 6071); sec. 6091 (68A Stat. 752; 26 U.S.C. 6091); sec. 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954))

[T.D. 7767, 46 FR 11277, Feb. 6, 1981]

### § 1.857-3 Net income from foreclosure property.

(a) *In general.* For purposes of section 857(b)(4)(B), net income from foreclosure property means the aggregate of—

(1) All gains and losses from sales or other dispositions of foreclosure property described in section 1221(1), and,

(2) The difference (hereinafter called “net gain or loss from operations”) between (i) the gross income derived from foreclosure property (as defined in section 856(e)) to the extent such gross income is not described in subparagraph (A), (B), (C), (D), (E), or (G) of section 856(c)(3), and (ii) the deductions allowed by chapter 1 of the Code which are directly connected with the production of such gross income.

Thus, the sum of the gains and losses from sales or other dispositions of foreclosure property described in section 1221(1) is aggregated with the net gain or loss from operations in arriving at net income from foreclosure property. For example, if for a taxable year a real estate investment trust has gain of \$100 from the sale of an item of foreclosure property described in section 1221(1), a loss of \$50 from the sale of an item of foreclosure property described in section 1221(1), gross income of \$25 from the rental of foreclosure property that is not gross income described in subparagraph (A), (B), (C), (D), or (G) of section 856(c)(3), and deductions of \$35 allowed by chapter 1 of the Code which are directly connected with the production of the rental income, the net income from foreclosure property for the taxable years is \$40 ((\$100 - \$50) + (\$25 - \$35)).